

First Supplement to Memorandum 2002-7

Mechanic's Liens: Double Payment Issue (Comments on Discussion Draft)

This supplement forward additional comments we have received on the Discussion Draft concerning *Consumer Protection Options Under Home Improvement Contracts*,:

	<i>Exhibit p.</i>
1. Gordon Hunt, Hunt, Ortmann, Blasco, Palffy & Rossell, Pasadena (Jan. 9, 2002)	1
2. Jan Hansen, Executive Director, Lumber Association of California and Nevada (Jan. 11, 2002)	4

Privity or Good Faith

Gordon Hunt does not believe the privity rule would work as a practical matter and that it would be unfair to subcontractors and suppliers. (Exhibit pp. 1-2.) He also argues that the equitable lien would a meaningless remedy. As to the good faith rule, he writes that it would effectively eliminate lien and stop notice rights. (Exhibit p. 2.) Mr. Hunt suggests, however, that adoption of a direct pay notice scheme in connection with the good faith rule would protect both homeowners and subs and suppliers.

Jan Hansen, Executive Director of the Lumber Association of California and Nevada, reports that the LACN members are reticent to agree to changes in their mechanic's lien rights because they do not believe a sufficient problem exists. (Exhibit p. 3.) But between the two alternatives, LACN members would support the good-faith rule over the privity rule.

Amount of Cap

Gordon Hunt suggests a cap of \$10,000 for the project cap approach or \$500 per claimant in the alternative cap approach. (Exhibit p. 3.)

Jan Hansen writes that LACN members prefer a project cap set at \$10,000, "as there is no protection afforded under [the cap] for subcontractors or vendors." (Exhibit p. 4.)

Respectfully submitted,

Stan Ulrich
Assistant Executive Secretary

HUNT ORTMANN BLASCO PALFFY & ROSSELL, INC.

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GORDON HUNT

January 9, 2002

Law Revision Commission
PROPOSED

JAN 14 2002

File: _____

Stan Ulrich
California Law Revision Commission
4000 Middlefield Road, Room D-1
Palo Alto, CA 94303-4739

**Re: Law Revision Commission
Discussion Draft Dated December 2001**

Dear Stan:

The Discussion Draft dated December 2001 requests comments on the proposals set forth therein. This letter will serve as written comments of the undersigned regarding said proposals.

The first proposal is a privity rule limiting Mechanic's Lien and Stop Notice rights to claimants who have a contract with the homeowner, coupled with a recognition for claimants without a contract with the homeowner to seek an equitable lien on the owner's property to prevent unjust enrichment. It is respectfully submitted that the effect of this proposed rule will be to eliminate lien and Stop Notice rights on home improvement contracts in total. The reason for the foregoing statement is that as a practical matter, all home improvement contracts are constructed with a prime contractor in place. Very few, if any, home improvement contracts are constructed under an "owner-builder" approach. The privity rule would require the subcontractors and material suppliers (who never have a contractual relationship with the owner) to now seek to obtain a contractual relationship with the owner in order to preserve their lien and Stop Notice rights. This would, of course, turn the traditional method of contracting for home improvements on its head. Most homeowners will not want to have a direct contractual relationship with the subcontractors and material suppliers. Most homeowners would find it difficult to schedule and coordinate the work of all the subcontractors and material suppliers. Most homeowners need the prime contractor to schedule and coordinate the work. Most prime contractors would not want the owner to have a direct contractual relationship with the subcontractors and material suppliers in that the prime contractor would then lose control over the project.

It is respectfully submitted that as a practical matter, the privity rule will not work. It is therefore respectfully submitted that it should not be adopted.

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The right to maintain a "equitable lien" is meaningless. The only time an "equitable lien" would be available would be if the owner had not paid the prime contractor thereby being unjustly enriched by receiving the work of the subcontractors and material suppliers without having the obligation to pay for it. This would rarely occur as a practical matter.

It is respectfully submitted that the privity rule is likewise unfair to the subcontractors and material suppliers. It is the belief of this consultant that the Commissioners have expressed a desire to protect homeowners from double payment, but to likewise give protection to the subcontractors and material suppliers. This privity rule will certainly protect the owners, but not protect the interests of the subcontractors and material suppliers. As noted above, as a practical matter, it will probably be impossible for the subcontractors and material suppliers to be able to bargain and obtain a contractual relationship with the owner in light of the manner in which the home improvement business works. As a result of the privity rule, the subcontractors' and material suppliers' interest in the real property would be lost and not protected. It is respectfully submitted that this does not comport with the expressed intent of the Commissioners to protect both the homeowner and the unpaid subcontractors and material suppliers who, in fact, create the very improvements which the owner benefits from.

The second option is called "Limited Protection for Good Faith Payments" . The text states that the good faith payment rule would protect homeowners by limiting their liability to the extent they have paid amounts due under the home improvement contract in good faith. It further states that it would leave existing Mechanic's Lien and Stop Notice remedies in place, but only applicable to the extent that amounts remain unpaid under the home improvement contract. It further states that subcontractors and suppliers would continue to serve 20-Day Notices, but the Mechanic's Lien liability would be limited to amounts remaining unpaid or in the rare case amounts that were not paid in good faith. As a practical matter, this proposal acknowledges that it would be a rare case where amounts are not paid in good faith. It is respectfully submitted that the effect of this rule would be to eliminate lien and Stop Notice rights for subcontractors and material suppliers and thus, should not be adopted.

The Discussion Draft does not discuss what was suggested by the undersigned at the last meeting, to-wit, coupling either one of the two above proposals with a "Direct Pay Notice" provision. If subcontractors and suppliers were given the right to give the homeowner a "Direct Pay Notice" immediately on becoming involved in the project and thereby preclude a "good faith" payment by the owner to the prime contractor, this would protect both the homeowner and the subcontractors and material suppliers from diversion of the owner's funds by the prime contractor. If either Option 1 or Option 2, as set forth in the Discussion Draft of December, 2001, is adopted,

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it is respectfully submitted that it should be coupled with provisions allowing subcontractors and material suppliers to give a "Direct Pay Notice" to the owner where they are not in privity of contract with the owner and once the "Direct Pay Notice" is given to the owner, any payments made to the prime contractor after receipt of that notice would not be "in good faith". This would truly provide protections to both the homeowner and the subcontractors and material suppliers who have created the improvements which the owner receives the benefit of.

The Discussion Draft dated December 2001 also requests comments on what the caps should be and where they should be applied. In that connection, the undersigned would respectfully suggest a cap of \$10,000.00 on the entire project and a cap of \$500.00 for each claimant. It is respectfully submitted that this limitation on lien and stop notice rights of subcontractors and material suppliers should be limited to the small home improvement contracts if it is, in fact, adopted and recommended by the Commission.

I hope that the comments made herein will be of benefit to the Commissioners in their deliberations on January 18, 2002.

Very truly yours,

HUNT, ORTMANN, BLASCO,
PALFFY & ROSSELL, INC.



Gordon Hunt

GH:slg



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January 11, 2002

California Law Revision Commission
4000 Middlefield Road, Room D-1
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RE: Mechanic's Lien Proposals

Dear Commissioners:

On behalf of all of our members, we would like to thank you, and your staff, especially Stan Ulrich, for all of the time and dedication you have shown to your study of the issues presented by the "double payment" problem in the mechanic's lien area, and for your hard work to achieve a solution which adequately and properly addresses that situation without unduly imposing upon the rights of the trades to payment for labor and materials provided.

As you are aware from many presentations made by members of the Lumber Association of California & Nevada at the Commission's meetings, our members do not believe the problem exists to the extent that it is perceived to exist by others. As a result, they are reticent to agree with changes that would impact their mechanic's lien rights because of such problems. However, of the two alternatives being circulated by the Commission to be applicable to home improvement contract work, our members support the good-faith payment rule, which limits the liability of homeowners to the extent they have paid in good faith, but leaves existing mechanic's lien and stop notice remedies in place for any amounts remaining unpaid by the property owner.

With regard to the Commission's inquiry as to the limitation of such good-faith payment rule, the LACN members believe that the good faith payment rule should apply only to home improvement contracts under a maximum (total) contract amount of \$10,000, as there is no protection afforded under this proposed amount for subcontractors or vendors.

Sincerely,

Jan Hansen
Executive Director